

**Office of Chief Counsel
Internal Revenue Service
memorandum**

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to: Aziz Benbrahim
Tax Attaché
LM:IN:OO:PARIS

from: M Grace Fleeman
Senior Technical Reviewer, Branch 1
(International)

subject: Taxability of Private Pensions under the U.S.-Switzerland Treaty

This memorandum responds to your request for clarification regarding the application of Article 18 (Pensions and Annuities) of the U.S.-Switzerland income tax treaty (the "Treaty") to a U.S. citizen living in Switzerland and receiving distributions from his Individual Retirement Account ("IRA").

FACTS

Taxpayer is a U.S. citizen who has been living in Switzerland since [REDACTED]. Taxpayer worked only in the United States before retiring to Switzerland. He has rolled over his pension and profit-sharing plans to an IRA. As of [REDACTED], Switzerland has begun fully taxing Taxpayer's IRA distributions, advising him to get a foreign tax credit from the United States to alleviate double taxation.

ISSUE

Whether the distributions that Taxpayer receives from his IRA are taxable in the United States, Switzerland, or both?

CONCLUSION

Article 18(1) of the Treaty provides that Taxpayer's state of residence, Switzerland, has primary taxing jurisdiction over his IRA distributions. The saving clause in paragraph 2 of Article 1 (Personal Scope) gives the United States the right to tax Taxpayer's IRA distributions under the Internal Revenue Code ("Code") as if the Treaty had not come into effect. Double taxation would be alleviated under paragraph 3 of Article 23 (Relief from Double Taxation), which requires the United States to allow a credit for the Swiss tax paid in respect of the distributions.

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LAW & ANALYSIS

I. Pensions Article

Article 18(1) of the Treaty provides:

Subject to the provisions of Article 19 (Government Service and Social Security), pensions and other similar remuneration beneficially derived by a resident of a Contracting State in consideration of past employment shall be taxable only in that State.

The Treasury Department's 1997 Technical Explanation ("TE") to Article 18 explains, in relevant part:

Paragraph 1 provides that private pensions and other similar remuneration derived and beneficially owned by a resident of a Contracting State in consideration of past employment are taxable only in the State of residence of the recipient. Although the Convention does not make explicit the fact that the term "pensions and other similar remuneration" includes both periodic and lump-sum payments, it is understood that this would be the case under the domestic law of both Contracting States. Treatment of such payments under the prior Convention is essentially the same as under the Convention, except that the rules of the prior Convention apply only to periodic payments. The term "pensions and other similar remuneration" includes amounts paid by all private retirement plans and arrangements in consideration of past employment, regardless of whether they are qualified plans under U.S. law, including plans and arrangements described in section 457 or 414(d) of the Internal Revenue Code. It also includes an Individual Retirement Account.

As the TE notes, Article 18(1) applies to amounts distributed from an IRA. Furthermore, this result is generally the same as under the prior U.S.-Switzerland income tax treaty, which was in effect until 1998.¹ Thus, because Taxpayer is a resident of Switzerland, Article 18(1), standing alone, would prevent the United States from taxing Taxpayer's IRA distributions.

II. Saving Clause

Paragraph 2 of Article 1 (General Scope) of the Treaty contains the "saving clause" found in every U.S. tax treaty in one form or another:

Notwithstanding any provision of this Convention except paragraph 3 of this

¹ Article XI(2) of the prior treaty provided that private pensions derived from one of the Contracting States and paid to individuals residing in the other Contracting State shall be exempt from taxation in the former State (the country of source). See also PLR 8901053 (October 13, 1988).

Article, the United States may tax a person who is treated as a resident under its taxation laws (except where such person is determined to be a resident of Switzerland under the provisions of paragraphs 3 or 4 of Article 4 (Resident)) and its citizens (including its former citizens) as if this Convention had not come into effect.

The TE to Article 1 explains, in relevant part:

The United States reserves its right, except as provided in paragraph 3, to tax U.S. residents and citizens (including its former citizens) as provided in its internal law, notwithstanding any provisions of the Convention to the contrary. For example, if a resident of Switzerland performs independent personal services in the United States and the income from the services is not attributable to a fixed base in the United States, Article 14 (Independent Personal Services) would by its terms prevent the United States from taxing the income. If, however, the Swiss resident is also a citizen of the United States, the saving clause permits the United States to include the remuneration in the worldwide income of the citizen and subject it to tax under the normal Code rules (i.e., without regard to Code section 894(a)).

Because Taxpayer is a U.S. citizen, the saving clause permits the United States to tax his IRA distributions. Furthermore, Article 1(3) does not contain any exception from the saving clause for private pensions within the jurisdiction Article 18. Thus, the United States can tax Taxpayer's IRA distributions under the Code as if the Treaty had not come into effect.

III. Relief from Double Taxation

Taxpayer's IRA distributions are taxable in both Switzerland under Article 18(1) and the United States under Article 1(2). To alleviate double taxation, Taxpayer would look to Article 23 (Relief from Double Taxation) for one country to credit the tax paid to the other country.

The TE to the saving clause in Article 1(2) provides, in relevant part:

For special foreign tax credit rules applicable to the U.S. taxation of certain U.S. income of its citizens resident in Switzerland, see paragraph 3 of Article 23 (Relief from Double Taxation).

Article 23(3) provides:

Where a resident of Switzerland is also a citizen of the United States and is subject to United States income tax in respect of profits, income or gains which arise in the United States, the following rules apply:

- a) Switzerland will apply paragraph 1 as if the amount of tax paid to the

United States in respect of such profits, income or gains were the amount that would have been paid if the resident were not a citizen of the United States; and

b) for the purpose of computing the United States tax on such profits, income or gains, the United States shall allow as a credit against United States tax the income tax paid or accrued to Switzerland after the application of subparagraph a), provided that the credit so allowed shall not reduce the amount of the United States tax below the amount that is taken into account in applying subparagraph a); and

c) for the purpose of subparagraph b), profits, income or gains described in this paragraph shall be deemed to arise in Switzerland to the extent necessary to avoid double taxation of such income; however, the rules of this subparagraph shall not apply in determining credits against United States tax for foreign taxes other than the taxes referred to in subparagraph 2 a) and paragraph 3 of Article 2 (Taxes Covered).

These provisions apply to Taxpayer as follows. Subparagraph (a) provides that Switzerland will provide a foreign tax credit to Taxpayer as if the amount of U.S. taxes paid in respect of the IRA distributions received were the amount of U.S. taxes paid by a Swiss resident not a U.S. citizen. Because Article 18(1) provides that the IRA distributions received by a Swiss resident are taxable only in Switzerland, Switzerland is not required to provide any relief. Subparagraph (b) provides that the United States will credit the income tax paid or accrued to Switzerland after the application of subparagraph (a). Because the income described in paragraph 3 is U.S. source income, subparagraph (c) deems the income to be from Swiss sources to the extent necessary to avoid double taxation of such income.

As a result, Switzerland retains its primary taxing jurisdiction over Taxpayer's IRA distributions, and the United States provides a foreign tax credit against U.S. tax for Swiss tax paid in respect of those distributions. Article 23 is not subject to the saving clause of Article 1(2), so the United States will allow a credit to its citizens in accordance with the Article, even if a credit were not available under the Code. To claim the foreign tax credit, Taxpayer should file Form 1116 (Foreign Tax Credit).

Finally, note that as a U.S. citizen, Taxpayer is a U.S. person and not a foreign person. Code § 7701(a)(30)(A). As such, he cannot use Form W-8BEN (Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding) to claim an exemption from withholding. Furthermore, Taxpayer's IRA distributions are in fact subject to U.S. tax under Article 1(2) of the Treaty. Taxpayer is only eligible for a refund of U.S. tax to the extent that the United States will credit the tax paid to Switzerland in respect of his IRA distributions received.

If you have any additional questions, please contact Cheryl Edson at (202) 622-8555.